

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

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In the Matter of:

AN ADJUSTMENT OF RATES OF)
COGAN CO., INC., D/B/A MAPLE) CASE NO. 9130
GROVE SECTION 5 SEWER SYSTEM)

O R D E R

On September 10, 1984, Cogan Co., Inc., d/b/a Maple Grove Section 5 Sewer System, ("Maple Grove") filed an application with the Commission to increase its sewer rate pursuant to 807 KAR 5:076. This regulation permits utilities with 400 or fewer customers or \$200,000 or less gross annual revenues to use the alternative filing method ("ARF") to minimize the necessity for formal hearings, to reduce filing requirements and to shorten the time between the application and the Commission's final Order. This procedure minimizes rate case expenses to the utility and, therefore, results in lower rates to the ratepayers.

Maple Grove requested rates to produce an annual increase of \$37,854. In this Order, the Commission has granted rates to provide additional revenues of \$15,629.

TEST PERIOD

The Commission has accepted the 12-month period ending December 13, 1983, as the test period in this case.

REVENUES AND EXPENSES

Maple Grove had a net operating loss of \$17,358 for the test period. In order to reflect current operating conditions, Maple Grove proposed numerous adjustments to expenses resulting in a net operating loss of \$19,428. The appropriate level of net operating loss as determined by the Commission is \$4,016.

The Commission has accepted Maple Grove's pro forma revenues and expenses with the following adjustments:

Revenue Normalization

For the test period Maple Grove had operating revenue of \$41,320 from 407 customers. The Commission has increased operating revenue by \$2,392 to reflect normalized annual revenue based on the number of customers at test year end, for total operating revenue of \$43,712.

Electricity Expense

During the test period Maple Grove incurred purchased power expenses of \$23,593 which it proposed to increase to \$25,363. Using the actual test-period electric usage and the current rates being charged by its supplier, the Louisville Gas and Electric Company, the Commission has determined the adjusted level of this expense to be \$26,104 and has, therefore, increased Maple Grove's pro forma expense by \$741.

Routine Maintenance Service Fee

Maple Grove reported Routine Maintenance Service expense of \$10,200 for the test period and proposed no adjustment to this expense. Since the contract is between mutually-owned companies, Maple Grove and Andriot-Davidson's Service Company, Inc.,

("Andriot-Davidson"), the transaction is, by definition, at less-than-arms-length. Therefore, the burden of proof is on Maple Grove to demonstrate that the monthly charge for routine maintenance service is fair, just and reasonable.

In support of the fee charged by Andriot-Davidson, Maple Grove provided bids from two sewer operators proposing to provide routine maintenance service;¹ however, the bids provided did not contain sufficient detail as to what services were to be provided by the operators. Therefore, a comparison of the prices could not be made. Presumably as further support, Maple Grove provided a list showing hourly mechanics' labor charges at several car dealerships. However, this information is basically irrelevant and no evidence was provided as to why the Commission should consider the wages of auto mechanics when determining the reasonableness of transactions between mutually-owned companies or the fees for maintenance of sewage treatment plants.

In evaluating the reasonableness of the routine maintenance service fee in cases involving sewer utilities the Commission often compares the present fee to the level of this fee which was found reasonable in previous Commission Orders. In this instance,

¹ Response filed October 12, 1984, to Information Request of October 2, 1984.

Maple Grove's most recent rate Orders in Case Nos. 6503² and 6491³ issued on September 20, 1976,⁴ allowed a routine maintenance service fee of \$3,000 per year. A review of Maple Grove's annual reports since 1976 indicates that Maple Grove has experienced little, if any, increases in its customer base and that Maple Grove has made only minor additions to plant since the Commission's Order was entered in the previous rate case. Furthermore, there is no evidence to indicate that the increases in this fee above the \$3,000 expense found reasonable in September 1976 are related to increased levels of service provided by Andriot-Davidson.

It is the responsibility of this Commission to determine whether Maple Grove has shown its expense for routine maintenance service to be fair, just and reasonable. Based on the evidence of record, the Commission is of the opinion that Maple Grove has failed to make such a showing. Therefore, the Commission has made an adjustment which reflects a level of expense found reasonable in its previous rate proceeding. Such adjustment reflects an annual expense level of \$3,000 or a decrease of \$7,200 from the actual test year expense. In making this adjustment, the

² Notice of Adjustment of Rates of Cogan Company, Inc., d/b/a Maple Grove Sewage Treatment Plant.

³ Donna K. Bennett, et. al. - Complainants v. Cogan Company, Inc., d/b/a Maple Grove Sewage Treatment Plant - Defendant.

⁴ This Order was amended on May 3, 1977, however routine maintenance service fee was not affected.

Commission recognizes that this case was an ARF proceeding in which a hearing was not held. Therefore, Maple Grove is hereby apprised that the Commission will consider a motion for a formal hearing on this matter should Maple Grove indicate that it intends to submit persuasive proof in support of its test year expense for routine maintenance service.

Maintenance Expenses

Maple Grove's test period operations included \$6,216 for maintenance of treatment and disposal plant. An analysis of the individual invoices for the test period indicated that Maple Grove expended \$5,405 for repairs which were nonrecurring in nature, benefiting more than one economic period and therefore capital items. The Commission has therefore reduced the test period maintenance expense by \$5,405 and has allowed depreciation on the items in question in the amount of \$855, a net adjustment of \$4,550.

Insurance Expense

Insurance expenses for the test period included \$154 for term life insurance premiums for the President of Maple Grove. If the beneficiary of this policy is the utility, these premiums should be accounted for below-the-line as miscellaneous income deductions according to the Uniform System of Accounts for Class C and D Sewer Utilities. If the estate of the President is the beneficiary, Maple Grove has provided no evidence to indicate that the ratepayers receive material benefit as a result of this policy. The Commission has therefore reduced test period insurance expenses by \$154.

Miscellaneous General Expenses

During the test period, Maple Grove incurred finance charges of \$178 from Kentucky Sewer Service and \$1,629 from Andriot-Davidson. The finance charge is based upon 1-1/2 percent of the outstanding balance payable at the end of each month and is reported in Account 930, Miscellaneous General Expense.

The Commission has reviewed the request to recover these finance charges in this case. As previously stated, Maple Grove last requested rate relief in 1976. In the years subsequent to the Commission's decision in that case, Maple Grove's financial condition has deteriorated to the point that it could no longer remain current on its payments to vendors. Obviously, Maple Grove's failure to request rate relief while this situation developed is a material reason the finance charges have been incurred. The burden of obtaining sufficient revenues to pay operating costs clearly rests with the management of Maple Grove. The failure of Maple Grove to seek sufficient revenues to cover its operating costs in prior periods does not justify the request in this case to recover these costs from the present ratepayers and to allow Maple Grove to recover the cost of financing operations of prior years would constitute retroactive rate-making. Therefore, the Commission has excluded the finance charges of \$1,807.

Property Taxes

In response to Commission requests, Maple Grove submitted copies of property tax bills for the test period. The Jefferson

County property tax bill was \$405 based on the 1982 assessment and \$355 based on the 1983 assessment, a difference of \$50. Maple Grove expensed the 1982 bill during the test period. The Commission is of the opinion that the 1983 assessment is the proper bill to be expensed for the test period and has therefore reduced the pro forma property tax expense by \$50.

Interest Expense

Maple Grove incurred interest expense on long-term debt of \$5,163 for the test period. This interest expense relates to a lease agreement between Maple Grove and Citizens Fidelity Bank which was entered into in November 1981. A review of Commission records indicates that Maple Grove has never requested Commission authorization for this particular indebtedness, in violation of KRS 278.300 which requires that:

No utility shall issue any securities or evidences of indebtedness, or assume any obligation or liability in respect to the securities or evidences of indebtedness of any other person until it has been authorized to do so by Order of the Commission.⁵

In response to information requests,⁶ Maple Grove stated that the current debt is a restructuring of the debt authorized by the Commission in Case No. 6361. Maple Grove further stated that the original debt approved in Case No. 6361 was a lease arrangement with an option to purchase from the original owner of Maple Grove;

⁵ Kentucky Public Service Commission Law, Kentucky Revised Statutes, Chapter 278.

⁶ Refer to Item 11 of Response filed October 12, 1984, and to Item 9 of Response filed November 26, 1984.

that this agreement, entered into in 1973, was treated on the books as a principal and interest consideration of \$70,000 for 15 years at 6 percent interest; that the purchase option was exercised in 1981 by Cogan Company, Inc.; and that the proceeds from the refinancing of this lease were used to pay off the balance of the original lease and to reduce Maple Grove's obligations existing at that time. Maple Grove's 1982 and 1983 annual reports indicate that the interest rate on this lease was 14 percent, although the lease agreement indicates that interest is based on a rate at 2 and 1/2 percent above the prime rate. Maple Grove, when asked to explain the rationale for the restructuring, stated that "the trade off for current shorter term debt even considering the higher interest rate was an advantageous arrangement for Maple Grove."⁷

The Commission's review of previous Maple Grove cases indicates that the original lease agreement of 1973 was approved by the Commission, and that interest expense of \$3,500 was allowed pursuant to that agreement in Case Nos. 6503 and 6491. This allowance represented the average interest over the life of the lease agreement. Because the restructured loan was not approved by the Commission (nor was approval sought by Maple Grove), the Commission requested additional information in this case to evaluate the restructuring. After review of the information supplied by Maple Grove, the Commission is of the opinion that Maple Grove has failed to show that the restructuring was in the

⁷ Ibid., Item 9.

best interests of Maple Grove's ratepayers. Moreover, the Commission has herein noted Maple Grove's failure to request rate relief since its most recent rate Order issued in 1977. The Commission is of the opinion that to allow Maple Grove interest expense on the proceeds which were partially used to pay off obligations existing in 1981 would constitute retroactive rate-making given Maple Grove's failure to file for timely rate relief. The Commission will allow the interest expense on the original lease arrangement in the amount of \$3,500, a reduction in Maple Grove's test period interest expense of \$2,263. The Commission has adopted this position in fairness to Maple Grove, but advises Maple Grove that total disallowance of interest expense would not be unjustified in other instances where Commission authorization to enter into an indebtedness is not sought.

Other Interest Expense

Maple Grove incurred interest expense on notes payable to associated companies in the amount of \$587 for the test period. In response to a Commission request, Maple Grove stated that formal notes to these companies do not actually exist.⁸ Moreover, the Commission in numerous cases involving the owner of Maple Grove⁹ has disallowed these interest expenses for rate-making purposes on the basis that this debt is necessitated by failure to

⁸ Response filed October 12, Item 12.

⁹ Refer, for instance, to Order in Case No. 9103, The Application of Glengarry Utilities, Inc., d/b/a Glengarry Sewer System for a Rate Adjustment Pursuant to the Alternative Rate Filing Procedure for Small Utilities.

seek sufficient revenues to cover operating costs, and to allow such interest would constitute retroactive rate-making. The Commission finds no reason to alter its position in this case and has therefore disallowed these expenses in this instance.

Therefore, Maple Grove's adjusted operations at the end of the test period are as follows:

	<u>Pro Forma Requested</u>	<u>Commission Adjustments</u>	<u>Commission Adjusted</u>
Operating Revenues	\$ 41,320	\$ 2,392	\$ 43,712
Operating Expenses	60,748	(13,020)	47,728
Operating Income (Loss)	<u>\$ (19,428)</u>	<u>\$ 15,412</u>	<u>\$ (4,016)</u>
Interest Expense	<u>6,350</u>	<u>(2,850)</u>	<u>3,500</u>
Net Income (Loss)	<u><u>\$ (25,778)</u></u>	<u><u>\$ -18,262</u></u>	<u><u>\$ - (7,516)</u></u>

REVENUE REQUIREMENTS

The Commission has used the operating ratio method as the basis in determining sewer rates in the past and has found it to be a fair, just and reasonable method to both the utility and its customers. The Commission is of the opinion that a ratio of 88 percent is a fair, just and reasonable operating ratio in that it will enable Maple Grove to pay its operating expenses and provide an adequate debt service coverage with a reasonable return to the plant's owner. Therefore, the Commission finds that Maple Grove is entitled to adjust its rates to produce total revenues of \$59,571 which includes federal, state and Jefferson County income taxes of \$1,835 and interest expense of \$3,500. This results in an annual increase in revenue to Maple Grove of \$15,629 over normalized revenue of \$43,712 and interest income of \$230.

SUMMARY

On January 15, 1985, Maple Grove submitted notice to the Commission of its intent to begin charging the rates advertised in its original application as of February 15, 1985. In a letter of the Commission dated February 20, 1985, the effective date was recognized to be March 2, 1985. In its Order of February 28, 1985, the Commission ordered Maple Grove to maintain its records in such manner as would enable it, or the Commission, or any of its customers, to determine the amounts to be refunded and to whom due in the event a refund is ordered upon final determination of this case in accordance with 807 KAR 5:076, Section 8.

The Commission, after consideration of the evidence of record and being advised, is of the opinion and finds that:

1. The rate proposed by Maple Grove would produce revenues in excess of those found reasonable herein and should be denied upon application of KRS 278.030.

2. The rate in Appendix A should produce gross annual revenue of approximately \$59,571 and is the fair, just and reasonable rate for Maple Grove to charge for sewage service rendered on and after the date of this Order.

3. The rate charged by Maple Grove on and after March 2, 1985, is in excess of the rate approved herein, and therefore, the difference should be refunded to the appropriate customers.

IT IS THEREFORE ORDERED that the rate proposed by Maple Grove be and it hereby is denied.

IT IS FURTHER ORDERED that the rate in Appendix A is the fair, just and reasonable rate to be charged by Maple Grove for sewage service rendered on and after the date of this Order.

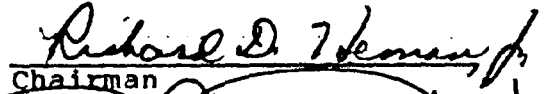
IT IS FURTHER ORDERED that the revenues collected by Maple Grove subsequent to March 2, 1985, through a rate in excess of that found reasonable herein shall be refunded in the first billing after the date of this order.

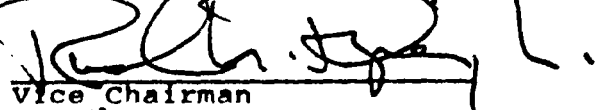
IT IS FURTHER ORDERED that Maple Grove shall file a statement within 30 days of the date of this Order reflecting the number of customers billed, the amount collected under the rate put into effect on March 2, 1985, the number of customers receiving a refund, the amount refunded and the date of the refund.

IT IS FURTHER ORDERED that, within 30 days of the date of this Order, Maple Grove shall file with this Commission its tariff sheets setting forth the rate approved herein.

Done at Frankfort, Kentucky, this 22nd day of March, 1985.

PUBLIC SERVICE COMMISSION


Chairman


Vice Chairman


Commissioner

ATTEST:

Secretary

APPENDIX A

APPENDIX TO AN ORDER OF THE PUBLIC SERVICE
COMMISSION IN CASE NO. 9130 DATED 3/22/85

The following rate is prescribed for customers receiving sewer service from Cogan Company, Inc., d/b/a Maple Grove Sewer System. All other rates and charges not specifically mentioned herein shall remain the same as those in effect under authority of the Commission prior to the effective date of this Order.

Customer Class

Rate

Residential

\$12.20